Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, [redacted] 1928

No. [redacted] 31

BOTANY WORSTED MILLS, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED DECEMBER 22, 1927

CERTIORARI GRANTED FEBRUARY 27, 1928.

(33,111)

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927

No. 659

BOTANY WORSTED MILLS, PETITIONER,

vs.

THE UNITED STATES

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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[fol. 1]

SUPREME COURT OF THE UNITED STATES

BOTANY WORSTED MILLS, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent

PETITION FOR WRIT OF CERTIORARI

To the Honorable Supreme Court of the United States:

Your petitioner, Botany Worsted Mills, a corporation, respectfully represents

1. That on September 12, 1924, Petitioner brought an action against the United States in the Court of Claims for the recovery of $450,994.06, alleged to have been illegally assessed against and collected from it as part of its income tax for the year 1917. Such assessment was due to the disallowance by the Commissioner of Internal Revenue, as a deduction, of a portion of the amounts paid by Petitioner as compensation to its directors for the said year.

On defendant's failure to plead a general traverse was entered under Rule 34 of the Court of Claims. As stated in the court's opinion, the Government interposed two defenses: first, "that the amount paid the directors for 1917 was unreasonable compensation; and, second, that in 1919 the various tax matters of plaintiff for 1917 were finally settled by compromise and mutual agreement." (p.23).

On April 4, 1927, the Court of Claims handed down its opinion. It held that the disallowance was erroneous, but sustained the second defense.

In its findings of fact (No. XIX) the Court stated:

[fol. 2] "An investigation of the books of the plaintiff by a representative of the defendant disclosed to the Commissioner of Internal Revenue the necessity of making a different assessment against the plaintiff than appeared due from its said return for the year ending November 30, 1917. The taxes for the said year were to be determined by the settlement of questions relating to the bonus paid to the company's directors, excessive depreciation charged off

on the books of the company, and reserves charged to expenses.

"After much correspondence and numerous conferences extending over a period of several months in which the plaintiff was represented by its attorney, John Quinn, and by its assistant treasurer, W. J. Helmer, and other parties, and the defendant represented by Sidney Alexander, chief of the special audit section, Bureau of Internal Revenue, and others of his official associates *a compromise* was *agreed to* as to all of the differences. In the said conferences Alexander informed Quinn that in view of the fact that the organization controlled by the Alien Property Custodian had considered the compensation paid to the directors for the year 1918 as being fair and reasonable, the same conclusion 'could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917.' The results of the said conferences were reported by Quinn to the plaintiff's board of directors from time to time during their continuance.

* * * * * * *

"Thereafter amended returns were prepared and executed by plaintiff's executive officers, based upon the figures as agreed upon in the said conferences, and were filed with the Commissioner of Internal Revenue together with documentary evidence which it was agreed upon at the last conference should be furnished, and the tax so computed, with a slight change not material to this case, was paid by the plaintiff." (pp. 18-20. Italics ours.)

(Note.—The portion of the findings omitted above is a quotation from the evidence of an excerpt from the minutes of a meeting of your petitioner's board of directors. Otherwise the only findings relating to the alleged compromise have been here set forth in full.)

In its opinion, the court said,

"It is not claimed by the Government that plaintiff's taxes were settled under the provisions of section 3229. The theory upon which its defense on this point is based is that an agreement was entered into between plaintiff and the Commissioner of Internal Revenue under which plaintiff

accepted the partial disallowance as to compensation, and also received certain concessions as to other disputed items, the benefit of which it still enjoys, and that, therefore, plaintiff is estopped from recovery in this action.

* * * * * * *

"With the payment of the tax under the circumstances [fol. 3] surrounding this case the agreement, which is mentioned in the record as a 'gentleman's agreement,' *became in legal effect an executed contract of settlement.* Plaintiff now seeks to recover on account of the particular item which it regards as unfavorable to its interests, and at the same time hold to the advantage from the settlement of other items in dispute involved in the same general settlement." (pp. 24-26. Italics ours.)

Sec. 3229 of the Revised Statutes, referred to by the court, was the only statutory source of authority for the compromise of tax cases existing at the time. There was then in force Article 38 of the Regulations of the Treasury Department under the Act of 1918 (Regs. No. 33 Revised, promulgated January 2, 1918) which reads as follows:

"Treasury decisions promulgating rulings of the Internal Revenue Bureau become effective upon the date of approval unless otherwise stated therein. Cases previously adjusted in contravention of law as pronounced in such decisions, are subject to readjustment in accordance with the decision."

Judgment was directed against petitioner on April 4, 1927. A motion for a new trial, filed May 17, was denied on November 7, 1927.

II. That the judgment of the Court of Claims of the United States is erroneous and that this Honorable Court should require that this action be certified to it for its review and determination.

III. That the ground upon which this writ is requested is that the Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court, and has decided such question in a way in conflict with the applicable decisions of this Court.

IV. That the reasons relied on for the allowance of this writ are as follows:

1. The Court of Claims has held in this case that an oral compromise agreement, made otherwise than as authorized [fol. 4] by statute, between subordinate officials of the Bureau of Internal Revenue and a taxpayer, may, when followed by the filing of an amended return and payment of the tax in accordance with the figures agreed on, become, in legal effect, an executed contract of settlement. Such decision is believed by Petitioner to be contrary to doctrines long and clearly established relating to the authority of public officers. It asserts a power in the Commissioner of Internal Revenue, and his subordinates, to bind the United States to contracts in compromise of tax cases made otherwise than in accordance with the express authority granted by statute and thus to override the limitations on his authority prescribed by the statute.

The decision of the Court of Claims is, furthermore, contrary to the view which has heretofore been held by the Bureau of Internal Revenue and the Attorney General and is now being asserted by them in other important pending cases, (including one before the Board of Tax Appeals and one before the Circuit Court of Appeals for the Sixth Circuit) to the effect that an agreement between the Government and a taxpayer, made otherwise than pursuant to the provisions of the statute, cannot be effective either as a valid settlement contract or as binding the parties by estoppel.

Since the date of the alleged compromise in this case, Congress has enacted statutes (Sec. 1312 of the Revenue Act of 1921, substantially repeated in Sec. 1006 of the Revenue Act of 1924) providing a new method by which a final settlement may be made in tax cases by agreement in writing between the taxpayer and the Commissioner, with the approval of the Secretary of the Treasury. If the decision of the Court of Claims in this case is not reviewed and reversed by this court, it will stand as a precedent whereunder the provisions of the Acts of 1921 and 1924, made for [fol. 5] the protection both of taxpayers and the United States, may be circumvented.

The law has been left by the decision of the Court of Claims in a state of perplexing uncertainty. In holding

that an unauthorized compromise between the Government and a taxpayer may, under certain circumstances, become effective as an executed contract of settlement, it has failed to make clear what circumstances may be effective to take the place of the requirements set forth in the statute.

2. If the decision of the Court of Claims herein was based on an equitable estoppel, it is in conflict with the applicable decisions of this Court in the following respects:

(a) There is no finding, as an ultimate fact, that any benefit was received by Petitioner in the compromise in respect of any item other than directors' compensation or that any concession was made to it to which it was not entitled as matter of prior right. The findings include a fragment of the evidence (contrary to the rules of this Court) and, in its opinion, the Court of Claims has drawn from such fragment an unwarrantable inference of the existence of facts which it has not found.

(b) Estoppel was not pleaded and was therefore waived by the defendant. It was not in issue in the case.

(c) Even if benefits to which it was not entitled were conceded to your petitioner in the unauthorized compromise, such fact should not constitute a complete bar to recovery but should, at most, be given consideration only to the extent of permitting the Government to establish the existence and amount of such benefits by way of counterclaim [fols. 6 & 7] or offset.

Wherefore your petitioner respectfully prays that a writ of certiorari be issued under the seal of this Court, directed to the Court of Claims of the United States, commanding the said Court to certify and send to this Court on a day to be designated a full and complete transcript of the record in that Court had in said cause, to the end that the judgment of the said Court of Claims may be reviewed by this Honorable Court as provided by the Statutes of the United States; and that the said judgment of the Court of Claims be reversed by this Honorable Court, and for such further relief as may seem proper.

And your petitioner will ever pray.

Botany Worsted Mills, Petitioner. Nathan A. Smyth, Counsel.

STATE OF NEW YORK,
County of New York, ss:

Alfred De Liagre, Secretary of Botany Worsted Mills, the claimant corporation, being duly sworn, deposes and says: I am Secretary of Botany Worsted Mills, the petitioner in this case. I have read the above petition and the matters therein stated are true, to the best of my knowledge and belief.

Alfred De Liagre. (Seal Botany Worsted Mills, Incorporated, 1889, Passaic, N. J.) Subscribed and sworn to before me this 21st day of December. Harry W. Bohmke, Notary Public. Kings Co. Clerk's No. 257. Reg. No. 8253. N. Y. Co. Clerk's No. 532. Reg. No. 8412. Commission Expires March 30, 1928. (Seal Harry W. Bohmke, Notary Public, Kings County.

[fols. a & 1] IN COURT OF CLAIMS OF THE UNITED STATES

No. D-747

BOTANY WORSTED MILLS, a Corporation,

vs.

THE UNITED STATES

I. PETITION—Filed September 12, 1924

To the Honorable The Court of Claims:

The claimant, Botany Worsted Mills, respectfully represents:

I

The claimant is a corporation duly organized and existing under and by virtue of the laws of the State of New Jersey, having its principal office at Passaic in said State and is now and was during all of the times hereinafter mentioned engaged in the general business of manufacturing woolen and worsted fabrics and selling the same throughout the United States and elsewhere.

II

Under the provisions of an act of Congress approved September 8, 1916, entitled "An act to increase the revenue and for other purposes" (39 Stat. L. 756) and an act of [fol. 2] Congress approved October 3, 1917, entitled "An act to provide revenue, to defray war expenses and for other purposes" (40 Stat. L. 300) and regulations of the Treasury Department entitled "Regulations No. 33 covering the collection of the income tax imposed by the act of September 8, 1916, as amended by the act of October 3, 1917," approved by the Secretary of the Treasury on January 2, 1918, the claimant prepared and filed its return of net income for the taxable year ending November 30, 1917. Claimant endeavored to make its said return in strict accordance with the requirements of the said statutes and regulations, and the claimant paid on, to wit, June 14, 1918, to the United States, taxes in the sum of $2,981,167.77 in accordance with the return filed as aforesaid.

III

In the said return for the year ending November 30, 1917, the claimant, acting in pursuance of Section 12 of an act of Congress approved September 8, 1916, entitled, "An Act to increase the revenue and for other purposes" (39 Stat. L. 756) and the said Treasury Department Regulations promulgated thereunder and approved by the Secretary of the Treasury as aforesaid, deducted compensation paid to its Board of Directors for the said taxable year, aggregating $1,565,739.39 in addition to other nominal salaries received by the individual members of said Board.

IV

The said sum of $1,565,739.39 was an obligation of the claimant for the taxable year ending November 30, 1917, by virtue of the several contracts, agreements and undertakings of employment between the claimant and the several members of the Board of Directors under the following circumstances:

[fol. 3] In the year 1889, prior to the employment of any of the members of the said Board of Directors, the claimant corporation incorporated in its by-laws the following—

"Par. 2. At the close of the business year the net profits shall be distributed as follows after suitable deductions shall have been made from the value of the property of the Company:

(1) A dividend of six (6%) per centum is to be paid to the stockholders in the computation of which said dividend payable on September 15th of the same business year shall be included.

(2) The balance remaining is to be applied as follows:

(a) Five (5%) per centum thereof shall be placed in a reserve fund until the amount of the reserve fund accumulated shall be equal to twenty (20%) per centum of the paid up capital of the Company for the time being.

(b) A compensation equal to thirty-two (32%) per centum of the said balance shall be allowed or paid to the Board of Directors for their services."

The said provision remained in the by-laws of the claimant corporation from that day until after the close of the taxable year 1917 and was in force and effect at the times that all of the several members of the Board of Directors were employed by the corporation and annual payments were made in accordance therewith, from 1889 until after the close of the taxable year 1917. The said sum of $1,565,739.39 was a sum equal to 32% of the balance of the net profits for the taxable year 1917 after the several deductions provided for in the said by-laws were made.

[fol. 4] V

On to wit, September 11, 1919, the Commissioner of Internal Revenue without legal authority disallowed as a deduction a portion of the said sum of $1,565,739.39 compensation of the Board of Directors, to wit, $783,656.06 of said sum. On or about the 17th day of June, 1920, an additional assessment in the aggregate sum of $703,578.37 was made against the claimant and the said sum was paid by the claimant to the United States on or about June 28, 1920. Of this amount $450,994.06 was attributable to the illegal disallowance by the Commissioner of Internal Revenue of the said sum of $783,656.06, a part of the compensation of the members of the Board of Directors, as a deduction for the taxable year 1917.

VI

On or about February 1, 1922, the claimant filed with the Commissioner of Internal Revenue a claim for refund of the said sum of $450,994.06 and the said claim was disallowed by the Commissioner of Internal Revenue on or about September 26, 1922.

VII

Under Sections 1019 and 1020 of the Revenue Act of 1924, the claimant may be allowed interest at the rate of 6% per annum on the said sum of $450,994.06 from June 28, 1920, the date of payment thereof.

VIII

The claimant therefore prays judgment against the United States in the sum of $450,994.06, together with interest thereon at 6% from June 28, 1920.

[fol. 5] IX

No action, other than as aforesaid, has been had on said claim in Congress or by any of the Departments; no person, other than the claimant, is the owner thereof or interested therein; no assignment or transfer of this claim or any part thereof or interest therein has been made; the claimant is justly entitled to the amount herein claimed from the United States after allowing all just claims and offsets; the claimant has at all times borne true allegiance to the government of the United States and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against the said government. The claimant is a citizen of the United States. And the claimant claims $450,994.06 together with interest at 6% from June 28, 1920.

Davies & Jones, Attorneys for Claimant.

Duly sworn to by Alfred De Liagre. Jurat omitted in printing.

[fol. 6] II. General Traverse—Nov. 12, 1924

No demurrer, plea, answer, counterclaim, setoff, claim of damages, demand, or defense in the premises, having

been entered on the part of the defendant, a general traverse is entered as provided by Rule 34.

III. Substitution of Attorney

On August 13, 1925, on motion made therefore, Nathan A. Smyth, Esq., was substituted as attorney of record, without prejudice to any lien or interest of the former attorneys.

IV. Argument and Submission

On November 8, 1927, this case was argued and submitted on merits by Mr. Nathan A. Smyth, for the plaintiff, and by Mr. R. C. Williamson, for the defendant.

[fol. 7]

V. **Special Findings of Fact, Conclusions of Law, and Opinion of the Court by Moss, J.**—April 4, 1927

This case having been heard by the Court of Claims, the court, upon the report of a commissioner and the evidence, makes the following

Special Findings of Fact

I

The plaintiff is a corporation duly organized and existing under and by virtue of the laws of the State of New Jersey, having its principal office at Passaic in said State, and is now and was during all of the times hereinafter mentioned engaged in the general business of manufacturing and selling woolen and worsted fabrics.

II

Under the provisions of an act of Congress approved September 8, 1918, entitled "An act to increase the revenue, and for other purposes," 39 Stat. 756, and an act of Congress approved October 3, 1917, entitled "An act to provide

revenue, to defray war expenses, and for other purposes," 40 Stat. 300, and regulations of the Treasury Department entitled "Regulations No. 33 covering the collection of the income tax imposed by the act of September 8, 1916, as amended by the act of October 3, 1917," approved by the Secretary of the Treasury on January 2, 1918, the plaintiff prepared and filed its return of net income for the taxable year ending November 30, 1917. Plaintiff paid to the United States, on June 14, 1918, taxes in the sum of $2,291,167.77, in accordance with the return filed.

III

In the said return for the year ending November 30, 1917, the plaintiff deducted amounts paid to the members of its board of directors for the said taxable year, aggregating $1,565,739.39, in addition to salaries of $9,000 each, received by the individual members of said board. The said sum of $1,565,739.39 was a sum equal to 32 per cent of the balance of the net profits for the taxable year 1917 and was paid in accordance with and after making the several deductions provided for in the by-laws of the plaintiff corporation.

[fol. 8]

IV

On September 11, 1919, the Commissioner of Internal Revenue disallowed as a deduction a portion of the said sum of $1,565,739.39, so paid as compensation to the members of the board of directors, to wit, $783,656.06 thereof. On or about the 17th day of June, 1920, an additional assessment in the aggregate sum of $703,578.37 was made against the plaintiff, and the said sum was paid by the plaintiff to the United States on or about June 28, 1920. Of this amount $450,994.06 was attributable to the said disallowance by the Commissioner of Internal Revenue of the said sum of $783,656.06, a part of the amounts paid to the members of the board of directors as a deduction for the taxable year 1917. Notices of said additional assessment were sent to plaintiff on June 15, 1920, and June 17, 1920, respectively. The disallowance so made was on the ground that the amounts paid as compensation were unreasonable, and that the deductions allowed represented fair and reasonable compensation.

V

On or about February 1, 1922, the plaintiff filed with the Commissioner of Internal Revenue a claim for refund of the said sum of $450,994.06, and the said claim was disallowed by the Commissioner of Internal Revenue on or about September 26, 1922.

VI

The plaintiff was incorporated in May, 1889, with an original authorized capital stock of $1,100,000. The authorized capital stock was increased in 1890 to $1,750,000, in 1899 to $2,500,000, in 1903 to $3,000,000, and in 1908 to $3,600,000.

VII

The plaintiff was organized by Eduard Stoehr, who was the head of a firm of woolen manufacturers doing business in Leipzig, Germany, known as Kammgarn-Spinnerei Stoehr & Company. A meeting of the stockholders of the plaintiff was held on January 11, 1890. From the records of that meeting it appears that at that time the owners of 9,180 shares out of the total 11,000 of authorized stock were citizens and residents of Germany. Of these shares 7,000 were owned by Kammgarn-Spinnerei Stoehr & Company, and 500 were owned by Eduard Stoehr. At that meeting of the stockholders the by-laws of the company were unanimously adopted. Said by-laws contained the following provisions:

"Article 22. Distribution of Profits

"Par. 1. After the close of every half of the business year of the company a computation of profits shall be made, and if practicable a dividend not exceeding three per centum shall be paid to the stockholders.

[fol. 9] "Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been maide from the value of the property of the company:

"'(1) A dividend of six per centum is to be paid to the stockholders, in the computation of which any dividend or dividends already paid to the stockholders during the same business year shall be included.

" 'The balance remaining is to be applied as follows:

" '(a) Five per centum shall be placed in a reserve fund until the amount of the reserve fund thus accumulated shall be equal to twenty per centum of the paid-up capital of the company for the time being.

" '(b) Twenty-five per centum is to be paid as a bonus to the board of directors.

" '(c) Seventy per centum is to be paid as additional dividend to the shareholders.'

"The board of directors may, however, with the consent of the majority of the shareholders, use a portion of the amount mentioned in the last paragraph, marked 'c' for special deductions from accounts or for the formation of a special reserve fund or for extra compensation to be paid to employees or for any institutions which will benefit the employees, such as pension funds and the like."

VIII

The said article 22 of the by-laws, adopted January 11, 1890, remained unchanged until April 11, 1903, at which time it was amended at a stockholders' meeting so that subdivision 2-b of paragraph 2 thereof read: "Forty per centum is to be paid as a bonus to the board of directors."

IX

The said subdivision 2-b of paragraph 2 of article 22 of the by-laws remained the same (except that said article was renumbered article 21 in August, 1904) until March 21, 1905, when it was amended at a meeting of the stockholders to read as follows:

"2-b. A compensation equal to forty per centum of the said balance shall be allowed or paid to the board of directors for their services."

X

The said subdivision 2-b remained unchanged until a meeting of the stockholders held on March 17, 1908, when article 21 of the by-laws was amended so that as a whole it read as follows:

"Par. 1. After the close of the first half of every business year of the company a computation of profits shall be made, and if practicable a dividend not exceeding three (3) per centum shall be paid to the stockholders. This dividend shall be payable on September 15th following.

"Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been made from the value of the property of the company:

[fol. 10] "(1) A dividend of six (6) per centum is to be paid to the stockholders, in the computation of which said dividend payable on September 15th of the same business year shall be included.

"(2) The balance remaining is to be applied as follows:

"(a) Five (5%) per centum thereof shall be placed in a reserve fund until the amount of the reserve fund accumulated shall be equal to twenty (20%) per centum of the paid-up capital of the company for the time being.

"(b) A compensation equal to thirty-two (32%) per centum of the said balance shall be allowed or paid to the board of directors for their services.

"(c) The residue is to be applied to the payment of an additional dividend to the stockholders, which is to be determined by the board of directors, subject to the approval of the stockholders at the annual meeting assembled. The board of directors may, however, with such approval of the stockholders, use a portion of said residue referred to in this paragraph (c) for special deductions from accounts or for the formation of special reserve funds or additional reserves, or for extra compensation to be paid to employees, or for any institutions which are designed to benefit the employees, such as pension funds and other similar institutions.

"Said additional dividend shall be payable on April 15th following the declaration thereof, unless the directors, with the approval of the stockholders, appoint another day for its payment."

The foregoing provisions remained in force until after the close of the taxable year 1917, and during that period compensation was paid to the directors in accordance therewith.

XI

The directors of plaintiff for the year 1917 were Thomas Prehn, Ferdinand Kuhn, Hans E. Stoehr, Max W. Stoehr, George Roehlig, Camill A. Mehl, Otto Kuhn, A. de Liagre, Edward Stoehr, and George Stoehr.

During the early part of the year 1918, 25,605 shares of the stock of the plaintiff were seized as alien property by the Alien Property Custodian, who by virtue of such control on the 2d day of April, 1918, caused a new board of directors of the plaintiff corporation to be elected. Such board consisted of:

Francis P. Garvan.
Horace C. Jones.
Andrew B. Duvall.
George T. Smith.
Max W. Stoehr.
Ferdinand Kuhn.
James N. Wallace.
Thomas J. Maloney.
H. C. McEldowney.
Thomas Prehn.
George Roehlig.

Of this board Messrs. Prehn, Stoehr, Roehlig, and Kuhn had previously been connected with the company. The other seven were nominees and representatives of the Alien Property Custodian. Mr. Garvan was at that time chief of the bureau of investigation in the Alien Property Custodian's office and in March, 1919, became Alien Property Custodian.

[fol. 11] XII

Subdivision 2-b of the by-laws was in effect all of the year 1917 and until July 30, 1918, when said subdivision 2-b was amended by the stockholders to read as follows:

"(b) Such sum, not exceeding thirty-two per cent (32%) thereof, as the board of directors shall in its sole discretion determine, shall be paid to the members of the board of directors and officers and executives or any of them as additional compensation for their services. Each such director,

officer, and executive shall receive of said sum such proportion as shall be determined by the board of directors. Said proportion may as to any one or more of said directors, officers, and executives be so determined after the close of said business year, or in the sole discretion of the board of directors at any time, prior to the close of said business year by contract between the company and such director, officer, or executive."

At the time of this amendment the Alien Property Custodian of the United States was the holder of record and voted the majority of the stock of the plaintiff.

XIII

From the outset the determination of the total amount of profits of the company and of the aggregate amount payable to the board of directors in accordance with the by-laws, was made by the board of directors. The basis of apportionment among the several directors of the aggregate amount payable to the board of directors as a whole, in accordance with the by-laws, was up to the year 1917 recommended to the board by its chairman, Eduard Stoehr, in conjunction with the treasurer and vice president. In the year 1918, Eduard Stoehr being in Germany, the apportionment was recommended by Hans Stoehr, treasurer of the company, in conjunction with a committee consisting of the president, Thomas Prehn, and the vice president, Ferdinand Kuhn.

XIV

No written or oral contract was at any time made with any of the directors as to what his compensation should be, other than such contract as was implied from his election to and acceptance of membership on the board, and his service as such a member in accordance with the by-laws and customary practices of the company, which were known to each such director. At all times each director held a position as an executive officer or manager of a department in the company. In 1918 express agreements were made between the company and the directors for a fixed salary and guaranteed bonus.

The ~~next~~ Net income of the plaintiff in the years indicated was as follows:

1910	$784,334.44
1911	456,440.02
1912	618,402.80
1913	497,090.61
1914	844,181.46
1915	1,393,922.43
1916	2,694,150.89
1917	7,953,512.80
1918	6,796,387.56

[fol. 12]

XV

The plaintiff paid to the directors in pursuance of the aforementioned by-laws the following amounts:

1910	$268,444.19
1911	132,704.85
1912	217,395.64
1913	169,925.00
1914	218,026.67
1915	400,935.18
1916	693,617.16
1917	1,565,739.39
1918	593,416.96

The plaintiff took credit in its tax returns for said payments in the years 1010, 1911, 1912, 1913, 1917, and 1918. In the years 1910 to 1916, inclusive, the Government did not allow any deduction for the amounts so paid and plaintiff paid its taxes accordingly for said years.

XVI

The gross assets of the plaintiff and its net assets, including reserves, as shown by its balance sheets, were as follows:

	Gross assets	Net, including reserves
1890	$1,114,149.63	$37,136.35
1900	8,888,243.37	2,138,306.56
1910	14,234,978.83	4,743,592.93
1917	28,893,777.12	10,999,862.48

XVII

At a meeting of the board of directors of the plaintiff, held March 25, 1918, the following resolution was adopted:

"Resolved, That the balance sheet and profit and loss account be spread in full on the minutes of the company; that the amount of four hundred thousand dollars ($400,000) be set aside for depreciation and also the amount of two hundred sixteen thousand dollars ($216,000), being six (6%) per cent dividend on the capital stock of the company, including three (3%) per cent dividend paid on September 15, 1917, as well as the compensation of the board of directors for the year 1917, namely thirty-two (32%) per cent of five million three hundred forty-five thousand seven hundred twenty-four dollars and thirty-five cents ($5,345,724.35), being equal to one million seven hundred ten thousand six hundred thirty-one dollars and seventy-nine cents ($1,710,631.79) be credited to the members of the board of directors in accordance with the by-laws of the company."

XVIII

On April 15, 1918, John Quinn was, at the suggestion of the Alien Property Custodian, duly elected counsel for the plaintiff company at a meeting of its board of directors, held on that day, and ceased to be counsel on March 29, 1921.

[fol. 13]

XIX

An investigation of the books of the plaintiff by a representative of the defendant disclosed to the Commissioner of Internal Revenue the necessity of making a different assessment against the plaintiff than appeared due from its said return for the year ending November 30, 1917. The taxes for the said year were to be determined by the settlement of questions relating to the bonus paid to the company's directors, excessive depreciation charged off on the books of the company, and reserves charged to expenses.

After much correspondence and numerous conferences extending over a period of several months in which the plaintiff was represented by its attorney, John Quinn, and by its assistant treasurer, W. J. Helmer, and other parties, and

the defendant represented by Sidney Alexander, chief of the special audit section, Bureau of Internal Revenue, and others of his official associates, a compromise was agreed to as to all of the differences. In the said conferences Alexander informed Quinn that in view of the fact that the orginzation controlled by the Alien Property Custodian had considered the compensation paid to the directors for the year 1918 as being fair and reasonable, the same conclusion "could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917." The results of the said conferences were reported by Quinn to the plaintiff's board of directors from time to time during their continuance.

The following is an excerpt from the minutes of a meeting of plaintiff's board of directors held April 23, 1920:

"* * * Counsel succeeded some time ago in effecting a compromise on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and which was satisfactory to the board.

"The company then received an assessment of $1,144,821.02, covering the years 1916, 1917, and part of 1918. This assessment was the subject of careful consideration by the company and conferences with counsel and conferences with the department by counsel, and the subject of supplemental memoranda and hearings.

"At the last hearing there was a great deal of discussion in regard to the reluctance of the department to allow for those years the large items of bonuses to employees and deductions for reserves, but they finally agreed to allow the bonuses to employees, the deductions for reserves, and all of counsel's other points.

"Counsel arranged an adjustment of the bonuses for the year 1917 on the same relative basis as the bonuses for the year 1918, approved by the reorganized board.

"Assuming that the bonus to directors in 1917 will remain as originally agreed to, that is, on the relative basis of the 1918 bonus, the additional tax to the Government for the years 1916, 1917, and 1918 will amount to $718,770.11.

"This shows a saving to the company between the original amount claimed and what will be the final assessment of $663,507.16.

"The Government accepted the contentions presented by counsel for the company on all of the essential questions [fol. 14] that counsel for the company and the officers of the company felt were right and proper under the law and facts."

Thereafter amended returns were prepared and executed by plaintiff's executive officers, based upon the figures as agreed upon in the said conferences, and were filed with the Commissioner of Internal Revenue together with documentary evidence which it was agreed upon at the last conference should be furnished, and the tax so computed, with a slight change not material to this case, was paid by the plaintiff.

XX

The total compensation paid to the executives and members of the board of directors for the year 1918 was allowed by the Commissioner of Internal Revenue as a proper deduction for that year.

XXI

John Quinn, Hans Stoehr, Otto Kuhn, Thomas Prehn, and George Roehlig, died prior to the joinder of issue herein.

XXII

The compensation of directors and executive officers for their services on the basis of percentage of profits has for many years been the practice among many corporations engaged in the woolen manufacturing business.

XXIII

In November, 1923, the Alien Property Custodian sold to Max W. Stoehr, pursuant to Executive order, 14,910 shares of the plaintiff company. In June, 1924, he likewise sold 2,455 shares to C. F. H. Johnson, and in November, 1924, he sold 5,310 such shares to C. F. H. Johnson. All of such shares, shortly after their purchase, were acquired and be-

came the property of Botany Consolidated Mills (Inc.), a Delaware corporation.

Conclusion of Law

Upon the foregoing special findings of fact, which are made part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover and that the petition should be dismissed.

Judgment is rendered against plaintiff in favor of the United States for the cost of printing the record in this case, the amount thereof to be entered by the clerk and collected by him according to law.

Opinion

Moss, Judge, delivered the opinion of the court:

In its tax return for the year 1917 plaintiff, Botany Worsted Mills, claimed as a deduction for compensation paid to its board of directors for the year 1917 the aggregate sum of $1,565,739.39 in addition to certain nominal [fol. 15] salaries paid to the members of said board. The Commissioner of Internal Revenue disallowed on this item the sum of $783,656.06, and on or about June 17, 1920, an additional assessment in the aggregate sum of $703,578.37 was made against plaintiff, which sum was paid by plaintiff on or about June 28, 1920. Of this amount $450,994.06 was attributable to the disallowance by the commissioner of the said sum of $783,656.06, being a portion of the amounts paid as compensation to its directors, and claimed as a deduction for the year 1917. On February 1, 1922, plaintiff filed with the commissioner a claim for the refund of said sum of $450,994.06, which claim was rejected. This action is for the recovery of said amount.

The tax in this case was collected under the act of September 8, 1916, 39 Stat. 756, as amended by the act of October 3, 1917, 40 Stat. 300, the applicable portion of which is as follows:

"§12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by de-

ducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, * * *."

On January 11, 1890, plaintiff incorporated in its by-laws the following provision:

"Par. 1. After the close of every half of the business year of the company a computation of profits shall be made, and if practicable a dividend not exceeding three per centum shall be paid to the stockholders.

"Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been made from the value of the property of the company:

" '(1) A dividend of six per centum is to be paid to the stockholders, in the computation of which any dividend or dividends already paid to the stockholders during the same business year shall be included.

" '(2) The balance remaining is to be applied as follows:

" '(a) Five per centum shall be placed in a reserve fund until the amount of the reserve fund thus accumulated shall be equal to twenty per centum of the paid-up capital of the company for the time being.

" '(b) Twenty-five per centum is to be paid as a bonus to the board of directors.

" '(c) Seventy per centum is to be paid as additional dividend to the shareholders.'

"The board of directors may, however, with the consent of the majority of the shareholders, use a portion of the amount mentioned in the last paragraph, marked 'c' for special deductions from accounts or for the formation of a special reserve fund or for extra compensation, to be paid to employees or for any institutions which will benefit the employees, such as pension funds and the like."

The above provision remained in effect until April 11, 1903, at which time it was amended so that subdivision 2-b of paragraph 2 thereof read: "Forty per centum is to be paid as a bonus to the board of directors." In March, 1908, it was again amended so as to provide as compensation to

the directors a sum equal to "32 per centum of said bal-
[fol. 16] ance * * *." From that time until after the close of the taxable year 1917 the above provision remained in force, and annual payments during that period have continuously been made in accordance therewith. The said sum of $1,565,739.39 was a sum equal to 32 per cent of the balance of the net profits for the taxable year 1917, after the several deductions provided for in said by-laws had been made.

The Government has interposed two defenses to this action: First, it is claimed that the amount paid the directors for 1917 was unreasonable compensation; and, second, that in 1919 the various tax matters of plaintiff for 1917 were finally settled by compromise and mutual agreement.

These contentions will be considered in the order named above.

It is shown by the record that during the whole period of plaintiff's existence its executive officers have been paid as compensation in addition to certain fixed salaries a percentage of the net earnings. The board of directors determined each year the aggregate amount payable to its members in accordance with the by-laws. The distributions among its members were made by the board on the recommendation of its chairman, in conjunction with its treasurer and vice president. Each director holds a position as an executive officer, or manager, of a certain department of the business. This method of compensation was consistently followed for nearly 30 years, during which time the gross assets of plaintiff company had increased from $1,114,-149.63 in 1890, to $28,893,777.12 in 1917; and its net assets, including reserves, had increased from $37,136.35 in 1890 to $10,999,862.48 in 1917. It is also made to appear that such method of compensating directors and officers has been the practice in many corporations engaged in the woolen manufacturing business. It follows, therefore, that the payment of such compensation to the directors of this corporation for the year 1917 constituted one of the "ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties * * *." The Commissioner of Internal Revenue, under the act of 1917, did not have authority to determine whether or not

compensation paid to its officers by a corporation was unreasonable compensation, and to limit the deduction to what he might consider reasonable compensation. He did have the right to determine whether or not the amount paid as compensation or salary was in fact something else, paid under the guise of salary. In this case the Government has not claimed that any part of the payments to the directors was not compensation, as claimed by plaintiff. The contention is, that the commissioner had authority to reduce the amounts actually paid to what he considered reasonable compensation. The case of United States v. Philadelphia Knitting Mills Company, 273 Fed. 657, decided June 13, 1921, seems conclusive on this point.

The Government contends that there was no legal authority at the time of the settlement of plaintiff's taxes for the compromise of taxes between the Government and a taxpayer, except as contained in section 3229 of the Revised Statutes, which reads as follows:

"The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may com- [fol. 17] promise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise," and that inasmuch as the procedure prescribed by this section was not adopted the agreement was invalid and unenforceable. It is not claimed by the Government that plaintiff's taxes were settled under the provisions of section 3229. The theory upon which its defense on this point is based is that an agreement was entered into between plaintiff and the Commissioner of Internal Revenue under which plaintiff accepted the partial disallowance as to compensation, and also re-

ceived certain concessions as to other disputed items, the benefit of which it still enjoys, and that, therefore, plaintiff is estopped from recovery in this action. In addition to the question of compensation there was pending at the same time and for the same year the question of depreciation and also the question of reserves charged to expenses. These items involved important amounts. All matters in dispute between plaintiff and the Government were settled, and the 1917 taxes were paid in accordance with the agreements theretofore reached in conference in the Internal Revenue Bureau. The negotiations in the bureau extended over a period of several months, involving considerable correspondence and numerous conferences.

With reference to the compensation item, it should be mentioned that on July 30, 1918, the Alien Property Custodian, holding more than two-thirds of the shares of plaintiff company, caused the by-laws with reference to the compensation feature to be amended so as to provide that the directors should thereafter receive such sum, not exceeding 32 per cent of the balance of the net profits, "as the board of directors shall in its sole discretion determine." Under the amended by-laws, and by the determination of the board, the directors received as their aggregate compensation for the year 1918 the sum of $593,416.96. In the conferences in the bureau plaintiff was represented by its counsel, John Quinn, who died before this action was instituted, and the bureau was represented by Sidney Alexander, then chief of what is called the special audit section, together with certain of his official associates. Plaintiff's counsel was advised by Alexander that in view of the fact that the new ownership, meaning the Alien Property Custodian, had considered the compensation for the year 1918 as being fair and reasonable, it was his opinion that the same conclusion "could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917." This item was finally settled on that basis. From time to time throughout the progress of the negotiations in the bureau plaintiff's counsel reported to its board of directors the substance of the matters occurring in such conferences. That plaintiff derived an advantage in the [fol. 18] settlement of this controversy is shown by the min-

utes of its board of directors of date April 23, 1920, wherein the various items in dispute, all having been agreed upon in conference, were discussed. (See Finding XIX.) The following statement is made:

"This shows a saving to the company, between the original amount claimed and what will be the final assessment, of $663,507.16."

Thereafter plaintiff prepared amended returns based upon the figures theretofore agreed upon in the bureau conferences, and same were forwarded to the Commissioner of Internal Revenue, together with certain documentary evidence which it was agreed at the last conference in the bureau should be furnished. With one slight change the tax shown by the amended returns was paid.

With the payment of the tax under the circumstances surrounding this case the agreement, which is mentioned in the record as a "gentleman's agreement," became in legal effect an executed contract of settlement. Plaintiff now seeks to recover on account of the particular item, which it regards as unfavorable to its interests, and at the same time hold to the advantage derived from the settlement of other items in dispute involved in the same general settlement.

It is the opinion of the court that plaintiff should not be allowed a recovery. It is therefore adjudged that the petition herein should be, and the same is hereby, dismissed.

Graham, Judge; Hay, Judge; Booth, Judge; and Campbell, Chief Justice, concur.

[fol. 19] VI. JUDGMENT

At a Court of Claims held in the City of Washington on the 4th day of April, A. D., 1927, judgment was ordered to be entered as follows:

The Court, upon due consideration of the premises, find in favor of the defendant, and do adjudge and order that the plaintiff, as aforesaid, is not entitled to recover and shall not have and recover any sum in this action of and from the United States; and that the petition herein be and it hereby is dismissed: And it is further adjudged and ordered

that the United States have and recover of and from the plaintiff, as aforesaid, the cost of printing the record in this court. No printing having been done by the court, no costs are taxed.

VII. Proceedings After Judgment

On May 17, 1927, the plaintiff filed a motion for a new trial.

On November 7, 1927, the court entered the following order and memorandum on said motion:

Order

It is ordered by the court this 7th day of November, 1927, that the plaintiff's motion for new trial be and the same is overruled.

Memorandum

On June *June* 6, 1927, a brief was filed herein by Holmes, Brewster & Ivins as amicus curiæ, in which it is alleged that the question of plaintiff's tax for the year 1918 is now pending and undetermined, and that "the opinion of the court implies an application of that decision to the tax liability of the plaintiff for 1918 as a binding precedent, whereas, to the contrary, no facts were presented in issue to this court with respect to the year 1918." We do not believe that the question of plaintiff's tax liability for any year other than the year 1917 is affected by the decision in this case.

[fol. 20] Clerk's certificate to foregoing transcript omitted in printing.

Endorsed on cover: File No. 33,111. Court of Claims, Term No. 659. Botany Worsted Mills, petitioner, vs. The United States. Petition for writ of certiorari and exhibit thereto. Filed December 22nd, 1927. File No. 33,111.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed February 27, 1928

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.